

**Achievement of Market-Friendly Initiatives and Results Program
(AMIR 2.0 Program)**

Funded By U.S. Agency for International Development

**Guide for Using the Risk Rating Grid for the
Social Security Investment Commission**

Final Report

**Deliverable for FMD Component, Work Plan Activity No. 638.02
Consultancy Agreement No. 278-C-00-02-00210-00**

September 22, 2003

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Data Page

Name of Component: Financial Markets Development

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Practice Area: Financial Sector

Service Offering: Pension Fund Reform

List of Key Words Contained in Report:

Risk Ratings

Underlying principles

Loan policy approach

Loan Action Plan

Industry peers

Financial factors

Non-financial factors

Company example

Final score

Management depth

Credit performance

Industry volatility

Weighted Net Score

Total weighted range of scores

Abstract

The purpose of this paper is to provide the credit analyst with objective criteria for evaluating loan applications. Both financial and non-financial factors are considered in calculating a weighted average score the analyst can use as one of the tools he or she should consider. We emphasize that this risk rating system presented here should not be used as a final determinant but as an objective criterion to be combined with the analyst's good judgment.

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Executive Summary

This paper presents underlying principles the credit analyst should consider when evaluating a loan application. Objective criteria are presented to determine a weighted average score employing both financial and non-financial factors. An example is shown to assist the analyst apply the system.

Underlying Principles (see Table A)

1. Provides underlying guidance and perspective on the specific risk rating being assigned to a given customer.
2. Changes in the Table would be valuable after a review of the current loan portfolio to provide support as an ongoing tool for credit evaluation.
3. The Table is a working document that should be periodically updated and tested. The document should be a living basis for reviewing issues and making changes every six months but at least every year. The grid should be considered a tool for making fine distinctions as a basis of understanding what the loan policy approach is all about.
4. The grid provides a broad overview of credit approval and should not be used as a substitute for understanding the capacity of the customer to repay the loan.
5. All formulae and usage of terms are derived and available from the Loan Action Plan. This guideline should be considered as another Addendum to the Loan Action Plan, previously presented to the SSIC.
6. Industry peers in Jordan will have to be based on public firms where numbers are available or private firms where SSIC has the available data due to other exposures.
7. If there are categories where the risk rating may be either one or the other (i.e., the rating could be either 2 or a 3), prudence demands picking the best (lowest) category for the firm in question.
8. For non-financial factors, the analyst should use good judgment as to where the firm fits as a result of due diligence.

ABC Company Example

Financial Factors

- In this example the firm fits in 1-2 times Funded Debt to EBITDA, which the 2 category.
- Debt Service Coverage is between 1.25 and 1.5 times and is in the 3 category
- Consistency of Cash Flow Coverage is in the top quartile of industry peers and greater than 1.5 times over two years for a category 1 score.
- Debt to Total Capital is in the top 10% of industry peers and therefore is a category 1 score.
- Current ratio is in top quartile of industry peers and between 1.5 and 2.0 and fits into the category 2 score.
- Quick Ratio is in top half of industry peers and between .5 and .75 thereby generating a score of 3.

Non-financial Factors

- In this example the firm's paper (its debt) is readily marketable since they already have a syndicated issue and are seeking another one, with lots of interest. The Category is marked as Category 1.
- Management has delivered on previous projections over a three year period and the firm fits into the 2 category.
- The firm has met all terms on an as agreed basis and is within trade terms on its payables. This earns the firm a category 1.
- The firm has a management team without depth in a couple of categories which earn the firm a category 3.
- Operational diversity for this firm is considered as category 2 with good diversity but lack of leadership.

- Industry volatility is in category 2 since the industry is considered stable with some but limited cyclical.

Calculation of the Final Score (see Table B)

The raw scores are added and then multiplied by the given factor for the perceived importance of the given factor. The sum of the weighted scores is then divided by the weights to get the weighted number which is 1.96 in this situation which would indicate that the firm is probably a 2 risk rating but is close to being a 1 risk rating. The score cutoff overall should be at about the middle of the three category meaning that above 3.0 should be “no” with those below “potentially more a “yes””. Again, this grid should give a basis for full completion of an application to create a consistent guideline but only a guideline. It is not intended to be used as an approval or disapproval.

Category Weight	Risk Ratings	1	2	3	4	5	6	7
	Financial Factors							
1	Funded Debt to EBITDA	<1.0 time	1-2 times	2-3 times	>3 times	>3 times	>3 times	>3 times
1.25	Debt Service Coverage	Top 10% of industry peers & >2.0 times	Top quartile of industry peers & 1.5 to 2.0 times	No lower than top 50% of industry peers & 1.25 to 1.5 times	Coverage > 1.0 times last 12 months	Coverage < 1.0 times last 12 months	Coverage < 1.0 times last 12 months	Coverage < 1.0 times last 12 months
1.5	Consistency of Cash Flow Coverage	Top 10% of industry peers & >2 times over >4 years	Top quartile of industry peers & 1.5 times over >2 years	No lower than top 50% of industry peers & 1.25 to 1.5 times over 1 year- previously volatile	Coverage > 1.0 times last 12 months but previously volatile	Coverage <1.0 for last 12 months and previously volatile	Coverage <1.0 for last 12 months and previously very volatile	Coverage <1.0 for last 12 months and previously very volatile
1.75	Debt to Total Capital	Top 10% of industry peers	Top quartile of industry peers	No lower than top 50% of industry peers	Bottom Quartile of industry peers	Bottom Quartile of industry peers	Bottom Quartile of industry peers	Bottom Quartile of industry peers
2.0	Current Ratio	Top 10% of industry peers & >2 to 1	Top quartile of industry peers & from 1.5 to 2.0	No lower than top 50% of industry peers & from 1.0 to 1.5	Below industry peers mean and below 1.0	Below industry peers third quartile and below .5	Below industry peers third quartile and below .5	Below industry peers third quartile and below .5
2.5	Quick Ratio	Top 10% of industry peers & >1 to 1	Top quartile of industry peers & .75 to 1.0	No lower than top 50% of industry peers & .5 to .75	Below industry peers mean and below .5	Below industry peers third quartile and below .25	Below industry peers third quartile and below .25	Below industry peers third quartile and below .25
	Non-Financial Factors							
1	Bank Market Acceptance of Paper	Readily	Acceptance within framework of market constraints	Very Challenging acceptance which must be there first for a new borrower	Not possible to achieve market acceptance without govt. guarantor	Not acceptable to market	Not acceptable to market	Not acceptable to market
1.25	Management	Management Proven and delivery of proj>5 years	Management delivery of proj3-5 years	Management Has delivered on recent LTM results Vs projections. Past discrepancies in proj vs. results have rational explanations	Management has fallen short of projections over LTM	Management has consistently not met projections	Management can't even generate accurate historic information	Even if management could generate accurate historic information, it is clear that it results would be much less than 1.0 coverage of ca fl

Category Weight	Risk Ratings	1	2	3	4	5	6	7
1.5	Loan and Credit Performance	As Agreed plus within terms on trade	As Agreed plus within terms on trade	As Agreed plus within terms on trade	As agreed but outside of terms on trade	Potentially past due 30 days and out of terms on trade	Category A –Past Due but not 90 days Category B-Past due >90 days	Non accrual and past due >90 days
1.75	Management Depth	Five year proven with depth and no dependence on one management team member	Depth and diversity with some potential dependence on individual members	Some lack of depth in management team	Some Management turnover evident with inexperience of management	Potential character deficiencies in management team &/or turnover without proven management replacements	Potential character deficiencies in management team &/or turnover without proven management replacements	Potential character deficiencies in management team &/or turnover without proven management replacements
2.0	Operational Diversity and Position within industry	Operational leadership within the leadership as defined in Porter Model Framework	Plant, product, customer, & supplier diversity.	Firm may be “stuck in the middle” from a Porter Model perspective	Concentrations evident which have impacted performance	Concentrations evident which have impacted performance	Concentrations evident which have impacted performance	Concentrations evident which have impacted performance
2.5	Industry Volatility	Stable mature and non-cyclical industry	Stable industry with some cyclicity	Cyclical industry	Start up industry with no proven cash flows or very high cyclicity	Start up industry with no proven cash flows or very high cyclicity	Start up industry with no proven cash flows or very high cyclicity	Start up industry with no proven cash flows or very high cyclicity